

# CRS Report for Congress

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## **Mandatory Spending: Evolution and Growth Since 1962**

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# Mandatory Spending: Evolution and Growth Since 1962

## Summary

Federal spending amounts to almost 20% of gross domestic product (GDP) and the federal deficit stands at nearly 4% of GDP. Projections suggest that with no changes in policy and the impending retirement of the large baby boom generation the United States is facing a long-term fiscal imbalance. Efforts to reduce the federal deficit and the long-term fiscal strain may include reductions in entitlement spending, a major component of mandatory spending. Mandatory spending is the government spending where the budget outlays are controlled by laws other than appropriation acts, and includes such popular programs as Social Security and Medicare. Other programs included in mandatory spending are temporary assistance to needy families (TANF), supplemental security income (SSI), unemployment insurance, veterans benefits, federal employee retirement and disability, food stamps, and the earned income tax credit.

The composition of mandatory spending has changed over the past 40 years. In 1962, before the introduction of Medicare, Medicaid, and SSI, mandatory spending accounted for less than 30% of all federal spending and Social Security accounted for half of all mandatory spending. By 2004, mandatory spending comprised over half of total federal spending and Social Security made up about 40% of mandatory spending. The fastest growing components of mandatory spending have been Medicare and Medicaid, which together accounted for over 36% of mandatory spending by 2004.

Mandatory spending has grown relative to GDP, with most of the growth occurring before 1975. Both Medicare and Medicaid have steadily grown relative to GDP from almost nothing in 1965 to about 3.8% of GDP in 2004. Social Security grew from 2.5% of GDP in 1962 to 4.3% in 2004. And lastly, SSI has been and is projected to continue to amount to between 0.2% and 0.3% of GDP.

The aging of the U.S. population, increasing life expectancy, and rising health care costs will put severe pressure on the federal budget over the next 75 years. Medicare and Medicaid are projected to amount to 5.3% of GDP by 2015 and to 18.9% in 2080. Social Security is projected to be 4.5% of GDP in 2015 and 6.4% of GDP by 2080.

With discretionary spending reduced to historic lows, any significant reductions in federal spending are likely to come from mandatory spending. Since most of the increases in federal spending occur in Social Security, Medicare, and Medicaid, these programs are likely to be targets for budget reductions. Focusing budget cuts on these three key programs, however, could compromise their goals and adversely affect the elderly and the poor. Over the next 75 years, the growth in Medicare and Medicaid are projected to be the largest contributors to the long-term fiscal shortfall. Fundamental reform of these programs may be proposed to eliminate the long-term fiscal strains while preserving the goals of these programs.

This report will be updated annually.

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# Mandatory Spending: Evolution and Growth Since 1962

While federal spending as a proportion of gross domestic product (GDP) has remained relatively constant over the past 40 years, the same cannot be said for the federal deficit. In 1962, the federal deficit was equal to 1.3% of GDP; by 2004 it was nearly 4% of GDP. Furthermore, the Congressional Budget Office (CBO) projects that the federal deficit will be greater than 2% for the next six years if policy follows current laws. Several studies as well as knowledgeable observers have warned of the dangers of the long-term fiscal imbalance.<sup>1</sup> Consequently, the Administration and Congress are under pressure to reduce this long-term fiscal strain. One option is to reduce federal spending. Thus, some people have called for reductions in entitlements, the major component of mandatory spending.

Mandatory or direct spending is the government spending where the budget authority and outlays are controlled by laws other than appropriation acts, and includes such popular programs as Social Security and Medicare. The two other broad categories of federal spending are discretionary spending which is controlled annually through the appropriation acts, and interest spending on the federal debt. Discretionary spending was subject to budget limits or “caps” in the 1990s. Consequently, discretionary spending as a proportion of total federal spending has fallen.

This report reviews the trends in mandatory spending since 1962. In addition, CBO’s baseline projections of mandatory spending to 2015 are reported. The report specifically examines the evolution of mandatory spending in relation to total federal spending and to the economy as a whole. It shows which components of mandatory spending have been growing and which ones have not.

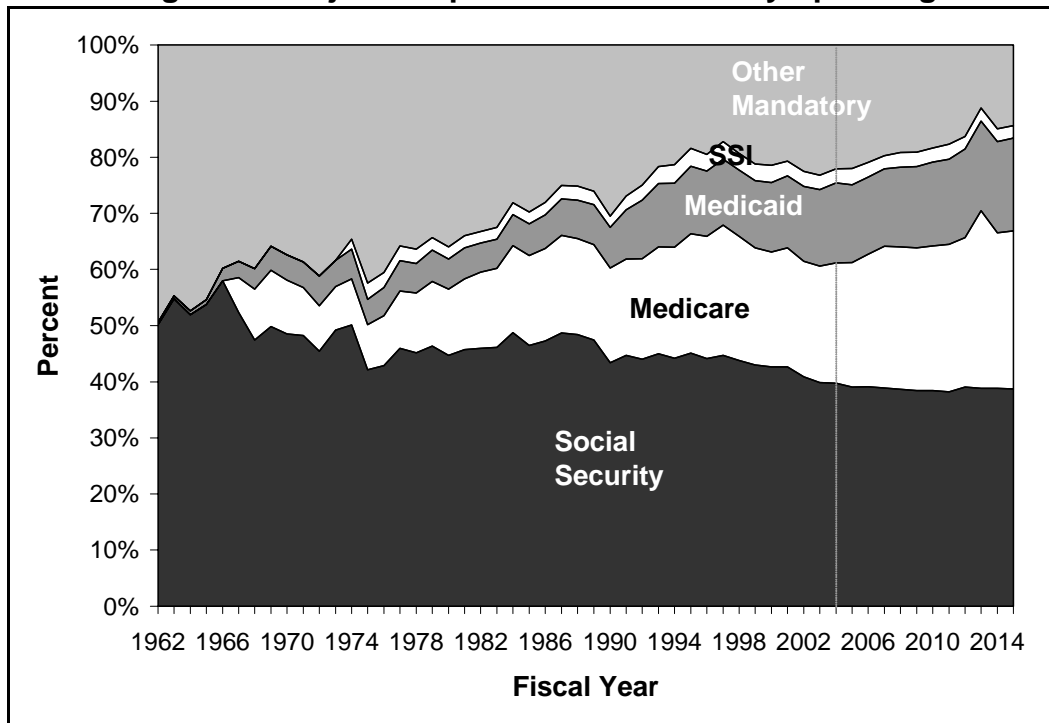
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<sup>1</sup> See Congressional Budget Office, *The Budget and Economic Outlook: An Update*, Aug. 2005; General Accounting Office, “Truth and Transparency: The Federal Government’s Financial Condition and Fiscal Outlook,” remarks by David M. Walker at the National Press Club, Sep. 17, 2003; Alan Greenspan, “Reflections on Central Banking,” remarks by Chairman Alan Greenspan at a symposium sponsored by the Federal Reserve Bank of Kansas City, Jackson Hole, WY, Aug. 26, 2005; Alan J. Auerbach, William G. Gale, and Peter R. Orszag, “Sources of the Long-term Fiscal Gap,” *Tax Notes*, May 24, 2004; CRS Report RL31235, *The Economics of the Federal Budget Deficit*, by Brian W. Cashell.

## Components of Mandatory Spending Since 1962

**Figure 1** shows the major components of mandatory spending since 1962. Also shown in the figure are CBO baseline projections<sup>2</sup> for these components to 2015. In 1962, neither Medicare nor Supplemental Security Income (SSI) existed and Medicaid accounted for less than one half of one percent of mandatory spending.<sup>3</sup> Mandatory spending was almost equally divided between Social Security (50.2%) and other mandatory spending (49.5%). Other mandatory spending includes spending on programs such as federal employees retirement and disability, unemployment insurance, deposit insurance, veterans benefits, food stamps and child nutrition programs, aid to families with dependent children (AFDC)/temporary assistance to needy families (TANF), housing assistance, and the refundable portion of the earned income tax credit (EITC).

**Figure 1. Major Components of Mandatory Spending**



Source: CBO and OMB.

Following the introduction of Medicare in 1965, spending on Medicare and Medicaid has accounted for an increasing share of mandatory spending. In 1970, Medicare and Medicaid made up 14.1% of mandatory spending. By 2004 it had

<sup>2</sup> CBO's baseline projections start with Congress's most recent budgetary decisions and then assume that no policy changes will be made over the projection period. For entitlement programs CBO assumes that current laws will continue unchanged and by law assumes that discretionary spending will grow at the rate of inflation throughout the projection period.

<sup>3</sup> In 1965, Medicaid was enacted to replace two federal programs that provided grants to states for medical care to the needy and elderly. The spending figures for Medicaid before 1965 are for these two programs.

grown to 35.6%. In 2004, Social Security outlays were 39.6% of mandatory spending, Medicare was 21.4%, Medicaid was 14.2%, SSI was 2.5%, and other mandatory spending was 22.0%.

CBO's baseline projection assumes that this trend of increasing health spending will continue. CBO projects that Medicare will account for almost 30% of mandatory spending by 2015 and Medicaid will make up 16%. Social Security outlays will account for 38.7% of mandatory spending, SSI 2.2%, and other mandatory spending 14.4%. The composition of mandatory spending has changed dramatically over the past 40 years and is projected to continue changing significantly over the next 10 years.

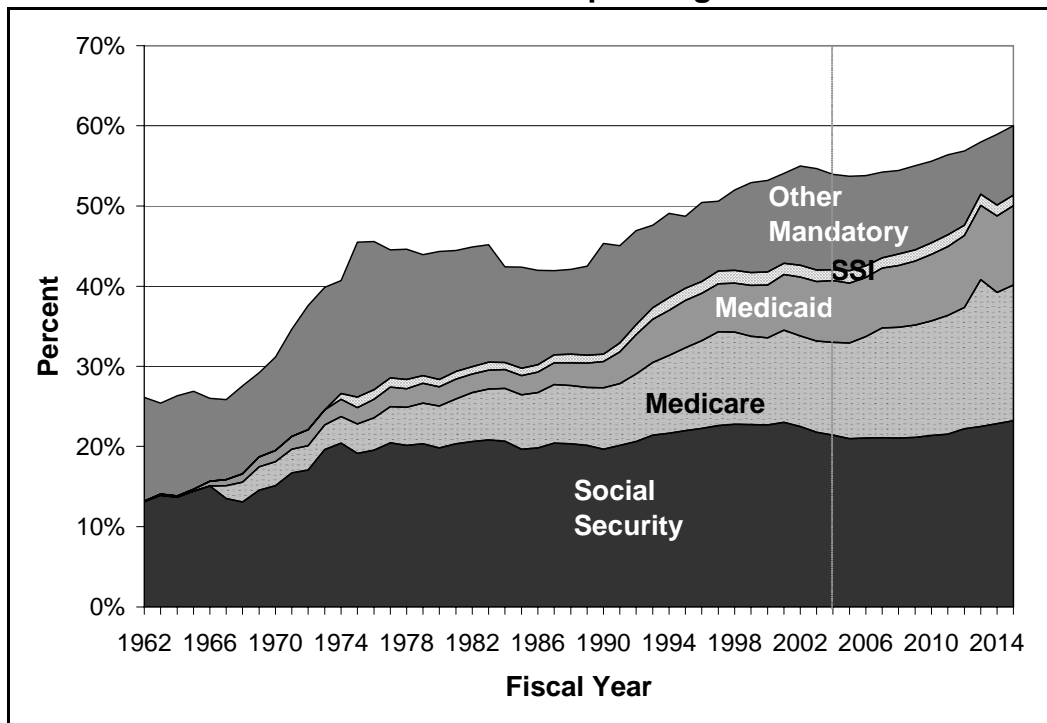
## The Relative Size of Mandatory Spending and Its Components

Not only has the composition of mandatory spending changed over the past four decades, but so too has its size relative to total federal spending and to the economy as a whole. The size of the components of mandatory spending relative to total federal spending provides information on the spending priorities of past Congresses, while the size relative to GDP provides information on the economic resources devoted to these programs.

### Mandatory Spending and Total Federal Spending

**Figure 2** displays the trends in mandatory spending and its components as a percentage of total federal spending since 1962. CBO baseline projections to 2015 are also shown. Mandatory spending (the top curve in **Figure 2**) comprised about 25% of total federal spending in 1962. Beginning in 1968, mandatory spending started growing relative to total federal spending and by 1975 accounted for about 45% of total spending. Over the next 15 years it remained a fairly steady proportion of total spending, but began growing again after 1990. Today mandatory spending accounts for 54% of total spending. CBO projects that mandatory spending will continue growing until it accounts for 60% of total spending in 2015. However, by law CBO assumes that discretionary spending will increase at the rate of inflation over the projection period. If discretionary spending is assumed to grow at the same rate as GDP, for example, then mandatory spending would be projected to account for 55% of total federal spending in 2015.

**Figure 2. Mandatory Spending and Its Components as a Percent of Total Federal Spending**



Source: CBO and OMB.

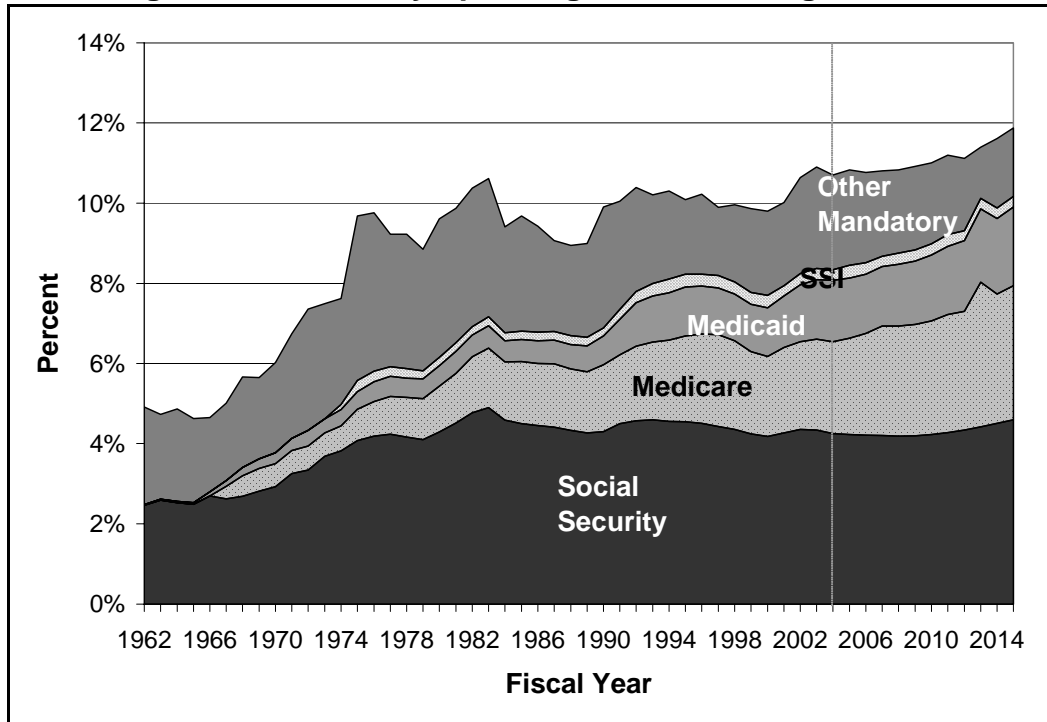
Although mandatory spending has grown relative to total federal spending, the various components of mandatory spending have followed trends that differ from one another. SSI has varied between 1% and 1.5% of total spending since its inception in 1974 and CBO projects that this trend will continue to 2015. Spending on Social Security grew somewhat as a proportion of total spending between 1962 and 1974, but has remained a relatively steady share of total federal spending since 1974 (at about 20%). Both Medicare and Medicaid have steadily grown relative to total federal spending and are projected to continue growing. In 2004, Medicare accounted for 11.6% of total spending while Medicaid accounted for 7.7%. CBO projects that Medicare will comprise 16.9% of total federal spending by 2015 and Medicaid will comprise another 9.9% of total spending. Lastly, “other mandatory spending” has fluctuated between 10% and 16% of total spending since 1962 but is projected to shrink to 8.6% of total federal spending by 2015.

## Mandatory Spending and the Economy

**Figure 3** shows the evolution of mandatory spending and its components in relation to GDP since 1962. Many of the same general trends are apparent in **Figure 3** as they were in **Figure 2**. Mandatory spending grew in relation to the economy between 1968 and 1975, and then remained relatively constant after 1974 at between 9% and 11% of GDP thereafter. Social Security spending grew relative to the economy from 2.5% of GDP in 1965 to 4.9% of GDP by 1983. After a slight dip in 1984, Social Security spending has been equal to about 4.5% of GDP since and is projected to continue at 4.5% of GDP until 2015. SSI has consistently been between

0.2% and 0.3% of GDP since 1962 and is projected to continue to do so. Both Medicare and Medicaid have grown in relation to the economy, and combined are projected by CBO to amount to 5.3% of GDP in 2015.

**Figure 3. Mandatory Spending as a Percentage of GDP**



Source: CBO and OMB.

## Real Growth in Mandatory Spending

**Table 1** reports the average annual real or inflation-adjusted growth rates for GDP, total federal spending, and mandatory spending since 1962. Also reported in the table are the average annual growth rates for the 1968 to 1975 period when mandatory spending increased dramatically. Over the full 43-year period from 1962 to 2004, the real growth of total federal spending was less than the real growth rate of GDP. However, the reverse was true during the 1968 to 1975 period when the growth rate of federal spending was greater than economic growth. Growth in mandatory spending outstripped economic growth in both the 43-year period and the shorter eight-year period. During the 1968 to 1975 period, the growth rate of mandatory spending was 4.5 times that of GDP.



**Table 1. Average Annual Real Growth Rates**  
(in percent)

	1962-2004	1968-1975
Gross Domestic Product	3.4	2.7
Total Federal Spending	3.1	3.1
Mandatory Spending	5.5	12.4
Social Security	4.8	8.9
Medicare	7.6	9.9
Medicaid	17.0	19.2
SSI	3.3	--
Other Mandatory Spending	4.4	15.4

**Source:** CRS calculations based on OMB data..

**Note:** SSI did not begin until 1974.

Over the 1962 to 2004 period, both Medicare and Medicaid grew at a higher rate than mandatory spending, total federal spending, and GDP. Real spending for Medicaid grew 17% per year over this period and 19.2% per year during the 1968 to 1975 period. The real growth rate for Medicare between 1965 and 2004 was 7.6%—2.1 percentage points greater than that for mandatory spending and 4.2 percentage points greater than the growth rate for GDP. In contrast, while Social Security grew at a higher rate than either GDP or total federal spending, it grew at a lower rate than mandatory spending (4.8% versus 5.5%). Real SSI spending, with a 3.3% real growth rate, has not kept pace with economic growth since its inception in 1974.

## Reasons Mandatory Spending Increased

Four major factors can be identified as to why mandatory spending increased in dollars terms and in relation to total federal spending and GDP. First, the decreasing importance of discretionary spending was the result of inflation-adjusted defense spending falling in the 1970s and discretionary spending not keeping pace with economic growth. Second, the economy experienced two recessions during the 1968 to 1975 period which lowered GDP growth and automatically increased spending on unemployment insurance and some means-tested programs such as food stamps. Third, the introduction of Medicare in 1965 combined with the dramatic rise in per capita health care costs due to new medical technologies, and the few incentives for consumers and medical providers to control costs dramatically increased program cost over the past 40 years. Lastly, the aging of the population and increased longevity of the elderly over the past 40 years increased spending for Social Security and Medicare.

## Mandatory Spending Beyond 2015

CBO's projections for the next 10 years do not capture the upcoming retirement of the large baby boom generation which will exert tremendous pressure on the federal budget. The oldest of the baby boom generation will reach age 65 in 2011 while the majority will not reach 65 years until after 2015. Projections suggest that Social Security spending could amount to 6.4% of GDP by 2080—an increase of 2% of GDP for the 2004 level.<sup>4</sup> If per capita health care costs continue to grow at their present rate, Medicare could amount to 13.8% of GDP and Medicaid could amount to 5.1% of GDP by 2080—an increase of 15% of GDP.<sup>5</sup>

## Conclusions

Over the past 4 decades, mandatory spending has grown as a proportion of total federal spending. And within the next decade, according to CBO projections, it will account for about 60% of total federal spending. Furthermore, mandatory spending has been growing relative to the economy whereas total federal spending has not. In 1962, Social Security accounted for half of all mandatory spending. Today, Social Security accounts for 40% of mandatory spending and the two health programs—Medicare and Medicaid—comprise about 36% of mandatory spending. CBO projects that the two health programs could makeup almost half of mandatory spending by 2015.

Knowing how mandatory spending and its components evolved and grew over the past 40 years will prove useful if efforts to reduce the federal deficit include reductions in mandatory spending. Three-quarters of mandatory spending is devoted to Social Security, Medicare, and Medicaid. Means-tested entitlements such as temporary assistance to needy families (TANF), SSI, food stamps, and housing assistance currently account for 8.5% of mandatory spending. Limiting budget reductions to the latter programs will not reduce the federal deficit by much and focusing budget cuts on the big three programs could adversely affect the elderly or the poor.

Nevertheless, most of the increases in federal spending have been occurring in Medicare and Medicaid. Furthermore, over the next 75 years, the growth in Medicare is projected to be the largest contributor to the large long-term fiscal shortfall.<sup>6</sup> Simply reducing the growth rates of Medicare and Medicaid would likely compromise the goals of these two important programs. Consequently, fundamental

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<sup>4</sup> Board of Trustees, *2005 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, Apr. 2005.

<sup>5</sup> Board of Trustees, *2005 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplemental Medical Insurance Trust Funds*, Mar. 2005; Alan J. Auerbach, William G. Gale, and Peter R. Orszag "Sources of the Long-term Fiscal Gap," *Tax Notes*, May 24, 2004.

<sup>6</sup> See CRS Report RS22232, *The Government's Long-term Fiscal Shortfall: How Much Is Attributable to Social Security?*, by Marc Labonte.

reform of the health programs may be proposed to eliminate long-term fiscal strains while preserving the goals of these programs.